

INDUSTRY SUBMISSION

Australia's Future Tax System
Retirement Income

February, 2009

Disclaimer:

This submission was developed by the Author and is based on discussions with a range of market practitioners and research provided by various parties.

The views expressed in this submission are intended to reflect the collective view of the SEQUAL Membership. However, no representation or warranty is given that either the Author or individual SEQUAL Members subscribe to each of the views herein described.

This submission has been prepared with care. However, neither the Author nor any SEQUAL Member is responsible for the results of any action taken on the basis of the information provided.

Copyright:

© SEQUAL, 2009. All Rights Reserved.

No part of this submission subject to Copyright may be reproduced.

SEQUAL makes every attempt to contact Copyright owners and request permission for the use of Copyright material. If notified, the SEQUAL will ensure full acknowledgement of the use of Copyright material.

Acknowledgements:

SEQUAL gratefully acknowledges the support of the following organisations through the provision of statistical data used in this submission:

The Australian Bureau of Statistics · ASIC · RFI · Datamonitor · Deloitte Actuaries

For further information regarding SEQUAL, please contact:

Kevin Conlon (M.App.Fin)
SEQUAL Chief Executive Officer
e : kevin@sequal.com.au
w: www.sequal.com.au
p: 61.2.9923 1871

Background

Funding Retirement -Equity Release Strategies

There is good reason to explore the options provided through equity release and the family home is now an intrinsic part of the planning process.

The strategies for Equity release through the use of Reverse Mortgages are diverse. For some retirees they are an effective means to supplement income or to provide access to capital. For others, they can be a tool to help manage market volatility. For frail retirees with poor health, it can provide them with choices for accessing the care they need and provides the ability to pay the aged care fees.

When used effectively, Reverse Mortgages can help a retiree to access the significant wealth they have accumulated in an illiquid asset in order to more effectively live the life that they choose.

The availability of Reverse Mortgages may assist Government to develop Retirement Income policies that are fair and which take proper account of the financial capacity of Senior Australians in order that taxpayer support is directed to those who are most in need.

Senior Australian's Equity Release Association of Lenders (SEQUAL)

SEQUAL is comprised of the major financial institutions offering Reverse Mortgages.

Since its inception as the peak industry body for the Australian Equity Release market, SEQUAL has worked in the interest of the community by imposing high standards of professionalism on those who design and distribute Equity Release products for Senior Australians.

SEQUAL is committed to the development of an ethical and efficient Seniors Equity Release market in Australia.

The Australian Reverse Mortgage Market

The most recent Deloitte SEQUAL Reverse Mortgage Study found that the Australian Reverse Mortgage market, as at 30 June 2008, consisted of more than 36,600 reverse mortgage loans with total outstanding lending of \$2.3 billion. This represents almost 14% growth over the six months to June 2008 and 27% growth over the 12 months from 30 June 2007.

Whilst demand for Reverse Mortgages is likely to continue to grow due to a number of compelling factors including demographic shift, the supply of Reverse Mortgages has been adversely impacted by the current global financial crisis. This market disruption has constrained the ability of some Reverse Mortgage providers to access funding with the effect that a number of SEQUAL Members have either withdrawn from the market or have significantly scaled-back their participation.

Given the vital public interest issues associated with the existence of a viable Seniors Equity Release market, Government clearly has an important role to perform in encouraging the efficient operation of Australia's financial markets and in particular, ensuring robust competition in the Reverse Mortgage market.

Table of Contents

1.	Property Ownership and the Wealth of Senior Australians.....	5
2.	The Seniors Equity Release Market.....	6
	How does a Reverse Mortgage work?	6
	The Size of the Reverse Mortgage Market.....	6
3.	How Can Reverse Mortgages Assist Seniors?	7
4.	How can Government Policy assist Senior Australians to help themselves?	8
	Consumer Education is crucial	8
	Opportunities to better target assistance to those in need	9
	Reverse Mortgage users should not be penalised under the pension	9
5.	How is SEQUAL ensuring the Emergence of an Ethical and Efficient Reverse Mortgage Market?.....	10
	Industry Accreditation.....	10
	<i>SEQUAL Code of Conduct and Guidelines</i>	10
6.	How Should Government Policy Assist the Development of the Australian Reverse Mortgage Market?.....	11
	Regulation of Reverse Mortgages	11
	Ensuring Quality Advice for Seniors	11
	Government Response to Capital Market Disruption.....	12
Attachment:		
	SEQUAL Code of Conduct.....	14

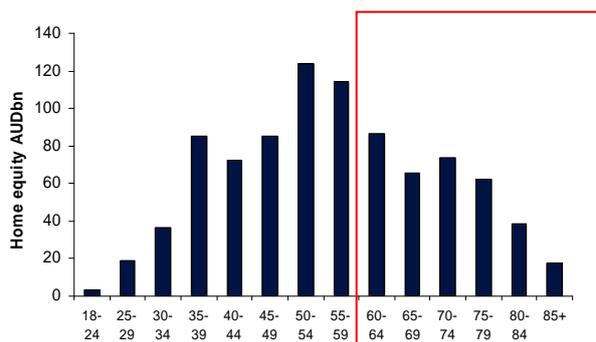
1. Property Ownership and the Wealth of Senior Australians

Many retirees have left the workforce poorly prepared via superannuation and other investments to fund their lifestyle until the end of their life. “Australia has a low household savings rate which results in our gross national savings rate rank of 17th out of the 28 OECD countries”.¹

In addition, more recent retirees, part of the so-called Baby Boomer generation, have increased expectations of their quality of life in retirement without significant liquid funds to enable this to be achieved.

“History, some might say, has been kind to the baby boomers. They have enjoyed affordable housing, access to free education, often generous welfare benefits and frequently favourable employment markets. Now the baby boomers – those people aged between about 45 and 65 years – will have to respond in a very real way to the challenges of an aging population, where the consequences of their actions now and throughout their lives will have ramifications for the generations to follow”.²

The good news is that the majority of Baby Boomers have achieved the “Great Australian Dream” of owning their own home. Total Home Equity (Owner Occupied) was \$887 billion, at the end of 2005. The Over 60s accounted for \$345bn (39%).



Source: Datamonitor

However, the absence of significant levels of savings (superannuation) and a concentration of wealth in an indivisible/illiquid asset (owner-occupied property), has made many Senior Australians “Asset-Rich but Cash-Poor”.

In the past, any retiree in this difficult position, had two choices; significantly reduce their living standards or sell the family home - often having to then move away from an established network of family and friends and in many cases reducing their age pension entitlements.

With the emergence of the Australian equity release market, retirees now have another option – tap into the stored wealth of their home.

¹ IFSA Submission to Australia’s Future Tax System Review. October, 2008

² AMP.NATSEM Income and Wealth Report. Issue No. 16. March 2007

2. The Seniors Equity Release Market

The dominant Seniors Equity Release product in Australia is the Reverse Mortgage.

Product design in Australia's Reverse Mortgage market is arguably "world-class" on the basis that the local market has benefitted from the lessons learned overseas, the competitive environment created by the involvement of both specialist lenders and major banks and the early establishment of SEQUAL as a peak body directing market practices.

How does a Reverse Mortgage work?

- It is a loan advanced as a lump sum or regular payment to a home-owning senior enabling them to access the equity in their own home.
- No repayments are made during the life of the loan, with the total outstanding payable on death, on sale of the property or on moving out of the home permanently.
- The No Negative Equity Guarantee limits the exposure of the borrower to the value of the property
- The Security is provided in the form of a conventional Mortgage Charge

The Size of the Reverse Mortgage Market

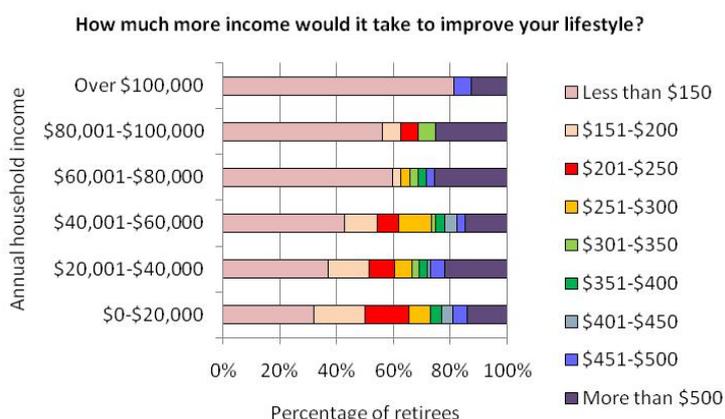
The SEQUAL/Trowbridge Deloitte Reverse Mortgage Study in December 2007 found that:

- There are 33,700 reverse mortgages
- The total outstanding value is \$2.02b
- The average loan size is \$60,000
- \$466m in new loans were drawn down in 2007, (75% of the Loan Facility Amount of \$627m)
- 18% of borrowers made additional draw downs from their loan account
- 10% of loans were taken as a regular income
- 10% of loans were paid back in full in 2007 and 6% were partially paid back, the vast majority being through voluntary repayment
- 30% of reverse mortgages were made outside the capital cities
- 44% of loans are to couples, 40% to single females and 16% to single males
- The average age of borrowers is 74 years, with 29% of loans made to those in their 60s, 50% to those in their 70s and 21% to those in their 80s

3. How Can Reverse Mortgages Assist Seniors?

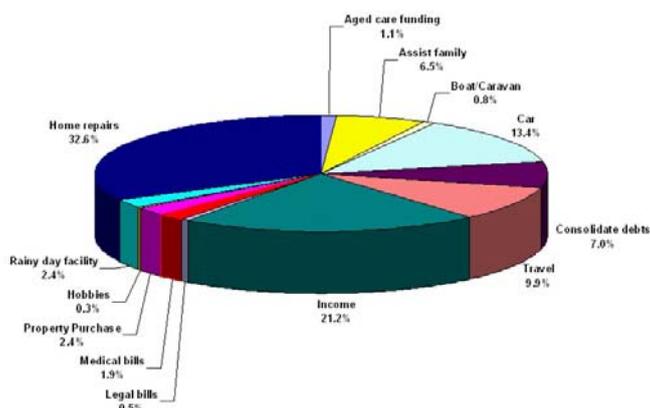
Even a modest draw down under a Reverse Mortgage can provide the opportunity for senior Australians to significantly improve their standard of living in retirement.

The 'It's on the House' SEQUAL-RFI Reverse Mortgage Study³ was conducted in October 2007 with phone interviews of 1000 Australians over the age of 60. This Study found that a modest increase to their income would significantly improve the lives of most retirees, with 50% of those surveyed indicating that as little as \$300 a month would be sufficient.



The Study also showed that a third of retirees (31%) expected to rely on their home as a source of retirement funding and revealed that baby boomers are not optimistic about their ability to fund their retirement, with a third fearing their funds would last only five to 10 years.

Reverse Mortgages are used for a variety of reasons by Senior Australians:



Source: ABN Amro Portfolio Analysis

Contrary to popular opinion, it is very rare that the proceeds are used for frivolous reasons. Some use them to supplement their retirement income, while others use them to replace their car or to renovate or upgrade their home, in many cases to help them cope with a disability. Other primary uses include for emergency medical treatment or to assist family members.

³ Report available for Download at: http://www.sequal.com.au/images/stories/sequal_rfi_study.pdf

4. How can Government Policy assist Senior Australians to help themselves?

Senior Australians cannot be classified as a single homogenous group. For pension policy purposes, it may be appropriate to consider the distribution of Government assistance based on home ownership. This distinction is currently applied in the assessment of the Assets Test and in other benefits entitlement (e.g. Rent Assistance).

Home ownership is an important foundation for the retirement plans of many Senior Australians, and it is important to ensure that any method of drawing an income from the wealth stored in the home is soundly based so that Seniors understand the options available to them in order that they can make fully-informed decisions.

Consumer Education is crucial

SEQUAL has worked with ASIC recently to develop a general education booklet for Australian Seniors. However, much more needs to be done to educate Senior Australians about their retirement funding options. It should be a priority for Government to ensure that Senior Australians are not deprived of a better understanding of the role that Equity Release can play in meeting their needs and preferences in retirement.

Government funding of balanced financial literacy programs and counselling services is crucial. SEQUAL acknowledges the valuable contribution made by Centrelink's Financial Information Service ("FIS"), and other agencies such as ASIC and NICRI. In particular, SEQUAL welcomes the recent launch Equity Release/Reverse Mortgage Information Centre operated by NICRI.⁴

NICRI CEO, Wendy Schilg says, "the new service, funded by the Commonwealth Department of Families, Housing, Community Services and Indigenous Affairs, has been made "essential" as adverse investment conditions force more older consumers to consider using their home equity to live on.

"For the past 12 months many retirees have watched the value of their investments fall substantially and rather than being forced to sell investments at a loss they are considering reverse mortgages as a way to bolster their income levels," Ms Schilg says.

"Older investors in managed funds with suspended redemptions or those who fail to qualify for Centrelink help may see a reverse mortgage as their only option".

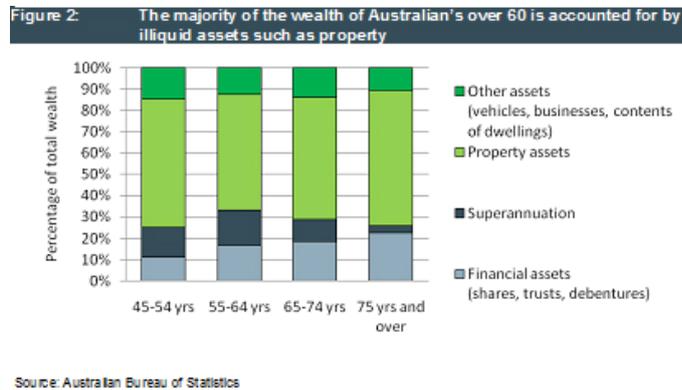
The service covers a range of topics including:

- Compound interest*
- Drawdown, lump sum or line of credit*
- No negative equity guarantees*
- Contract default clauses*
- Social security consequences*
- Provider details*

⁴ More Information can be found at: <http://reversemortgage.nicri.org.au>

Opportunities to better target assistance to those in need

In terms of targeted assistance, given the fact that commercial Seniors Equity Release options are now widely available to home-owning pensioners, consideration can be given to targeting additional Government income assistance to those most in need – pensioners without the safety net of owning the family home.



However, it is important to understand that some home-owning pensioners have homes which are not suitable for a reverse mortgage, possibly due to the low value of their home or its location, and this should be taken into account in any change of entitlements.

Reverse Mortgage users should not be penalised under the pension

It is also important to ensure that pensioners who utilise a reverse mortgage are not penalised by losing entitlements under the system. It is in the national interest to encourage Senior Australians to use their assets sensibly in retirement, including the family home where needed. However, any reductions in benefits that result from using a reverse mortgage will act as a deterrent to do so.

The current Centrelink assessment rules allow most retirees to access equity in their home via a reverse mortgage without adversely affecting their benefits. This is due to the existence of a rule allowing them to draw up to \$40,000 at a time for up to 90 days.

It is worth noting, however, that this amount is not indexed, and with the average reverse mortgage account sitting at \$60,000 at the end of 2007, it would be preferable to raise this amount to \$60,000 or more and to index it in the future to ensure that retirees supporting themselves with their home equity are not adversely affected.

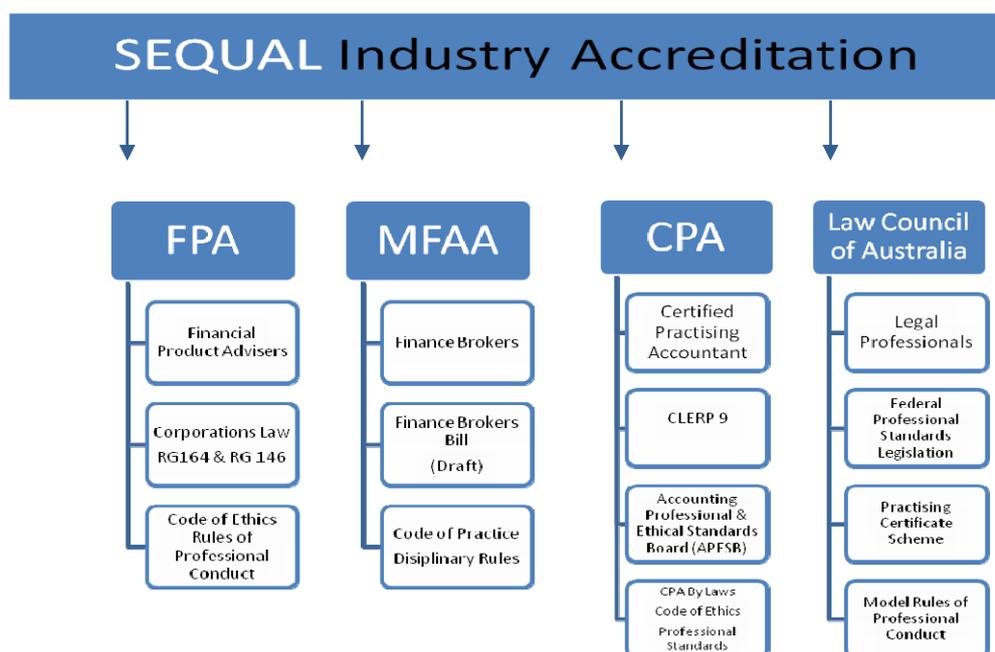
Consideration should be given to reviewing the gifting rules where the proceeds come from a currently exempt asset such as the family home.

5. How is SEQUAL ensuring the Emergence of an Ethical and Efficient Reverse Mortgage Market?

Industry Accreditation

SEQUAL has established an Industry Accreditation protocol in order to raise Professional Standards above the Minimum Education Requirements imposed by legislation and Industry Association Membership.

SEQUAL works closely with Industry Sector Associations to ensure that their Members are properly trained to assist their clients to make informed decisions about Equity Release.



To give effect to this protocol, SEQUAL has developed the educational standards required for market practitioners to achieve the designation of **Reverse Mortgage Consultant ("RMC")**.

The RMC designation forms an important part of SEQUAL's commitment to assisting consumers to identify properly-trained market practitioners.

SEQUAL Code of Conduct and Guidelines

SEQUAL Members are expected to comply with the SEQUAL Code of Conduct (see Attachment) and critical Policy Guidelines⁵ which are issue from time to time.

⁵ Download SEQUAL Code of Conduct and Policy Guidelines from: <http://www.sequal.com.au/content/view/21/38/>

6. How Should Government Policy Assist the Development of the Australian Reverse Mortgage Market?

Regulation of Reverse Mortgages

SEQUAL supports considered regulation that encourages the development of an ethical and efficient equity release market in Australia. It is important that Government have proper regard for the standards of industry practice that have been achieved by SEQUAL in consultation with Regulatory Bodies, Consumer Advocacy Agencies and Government itself, over an extended period of time.

*'ASIC welcomes industry moves to address consumers concerns about these products including the development of a code of practice by reverse mortgage providers industry group SEQUAL and the efforts of individual product providers to develop innovative provisions that mitigate some of the risks for consumers.'*⁶

SEQUAL is well-placed to influence the design and distribution of appropriate Reverse Mortgage products and the principles of the SEQUAL Code of Conduct should be preserved for the benefit of borrowers.

SEQUAL Policy Guidelines have introduced important consumer protection measures such as the preservation of the benefit of No Negative Equity Guarantees, and access to good quality independent financial and legal advice.

SEQUAL supports the Government's National Consumer Credit Reform⁷ initiative and expects to actively participate in Phase Two of the Action Plan as a Member of the Consumer and Industry Consultative Group.

Ensuring Quality Advice for Seniors

"In the relatively brief period before many baby boomers must begin to make concrete decisions about their retirement, most will have a series of choices to make about how they can maximise their retirement nest eggs.

*It is those boomers that take full advantage of the range of options available to them who are likely to be better off. Invariably, to get this right, people will need to access good financial advice".*⁸

It is crucial that market practitioners are willing and able to provide reliable advice to Senior Australians. Over 1,500 professionals (Brokers, Planners, Accountants and Lawyers have successfully graduated as SEQUAL-accredited Reverse Mortgage Consultants ("RMCs").

⁶ Mr. Greg Tanzer -ASIC Executive Director of Consumer Protection, November 2005

⁷Download the Action Plan: http://www.treasury.gov.au/documents/1381/PDF/NCC_Brochure_02102008.pdf

⁸ "Boomers Doing It For Themselves", AMP.NATSEM Income and Wealth Report Issue 16. March 2007

The RMC designation forms an important part of SEQUAL’s commitment to assisting consumers to easily identify and access properly-trained market practitioners who have gained Industry Accreditation.

Regulators have acknowledged the contribution being made by industry and they have delivered on their undertaking to “*work with industry to promote best practice and identify and appropriately deal with risks for consumers.*”⁹

The Australian Investments and Securities Commission (ASIC) provides a clear consumer guide at www.fido.asic.gov.au/equityrelease where it is stated that:

“The best way to address some of these risks and ensure you get the product that is most appropriate for your needs is to get **independent legal and financial advice**.

1. Make sure you get a lawyer to read the terms and conditions and explain exactly what you're signing up for.
2. On the financial side talk to someone who understands financial matters, knows your personal needs and will put your interest ahead of anything else. Always check how your adviser is being paid for the advice they give you.
3. **If you are using a mortgage broker, look for one who has received industry accreditation.**
4. Consult the Centrelink Financial Information Service or the Department of Veterans Affairs to see if it may impact on your pension entitlements.
5. Talk it over with your family.

In Australia advice about loans is fairly loosely regulated so be fussy about the people who advise you”.

The current National Credit Reform process will make a significant contribution towards improving the standards of market practise in the Mortgage Broker sector.

However, it is important that the Government recognise the important initiatives delivered by SEQUAL across the various industry sectors and provide active support for it.

Government Response to Capital Market Disruption.

- The Australian Reverse Mortgage Market currently stands at \$2.3 billion.
- The Reverse Mortgage market has been growing at around \$500 million p.a.
- SEQUAL is comprised of both Authorised Deposit-taking Institutions (“ADI’s) and Non-ADI’s

Since the deregulation of the financial system, the Residential Mortgage-Backed Securities (RMBS) market has provided an important source of funding for new and smaller mortgage lenders to compete with the major banks. However, the recent disruption to the international capital markets has adversely impacted liquidity in the RMBS market.

⁹ ASIC Report 59 Equity Release Products –November, 2005. Download at: [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Equity_release_report.pdf/\\$file/Equity_release_report.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Equity_release_report.pdf/$file/Equity_release_report.pdf)

The Treasurer announced on the 26th September, 2008 that the Australian Office of Financial Management (AOFM) would purchase Australian RMBS as part of the Government's commitment to strong and effective competition in Australia's mortgage markets.

This action followed legislation passed by the Rudd Government in June, 2008 which expanded the range of high-quality assets in which the AOFM can invest.

The Treasurer stated "The Rudd Government is committed to ensuring that Australia's financial markets continue to perform strongly and provide Australian households with a wide range of financial products at competitive prices"

In the past, few Australian Reverse Mortgage providers have accessed the RMBS market (RV-RMBS issuance) in order to fund their reverse Mortgage portfolios, as they have been able to readily access funding through bank-provided credit facilities. In more recent times, the availability of bank funding has tightened as a consequence of the impact of the global credit crisis.

In this environment, the RMBS market could be an important source of funds for Reverse Mortgage providers. However, the Selection Criteria established for the AOFM to invest in RMBS does not provide for Reverse Mortgage transactions.

The combination of these factors has constrained the ability of some Reverse Mortgage providers to access funding and the effect of these conditions is that a number of SEQUAL Members have either withdrawn from the market or have significantly scaled-back their participation.

Given the public interest issues associated with the emergence of an efficient Senior Equity Release market in Australia, consideration must now be given to a timely and effective Government Initiative aimed at preserving competition within the Australian Reverse Mortgage market and ensuring that Senior Australians have choices when considering Senior's Equity Release as a means by which to assist them to meet their retirement funding needs.

It may be appropriate to apply existing Government Initiatives (from both Australia and Overseas) to ensure that the Australian Reverse Mortgage market is competitive and stable. For example:

- An extension of the Selection Criteria for investment by the AOFM in RMBS to provide support for Reverse Mortgage RMBS issuance (RV-RMBS)¹⁰,
- The provision of a Government Guarantee to stabilise bank-provided funding¹¹ and,
- Government Insurance of Reverse Mortgage transactions.¹²

SEQUAL is committed to working with the Australian Government to assist Senior Australians to meet the challenge of Living Longer and Living Well.

¹⁰ Arrangements for the Purchase of RMBS: http://www.aofm.gov.au/content/notices/09_2008.asp

¹¹ The Australian Government Guarantee Scheme: <http://www.guaranteescheme.gov.au/>

¹² The US Home Equity Conversion Mortgage (HECM): <http://www.hud.gov/offices/hsg/sfh/hecm/hecmabou.cfm>

Attachment:

SEQUAL Code of Conduct

SEQUAL's Code of Conduct encourages the responsible use of Equity Release in the community. The Code of Conduct requires SEQUAL members to:

1. Treat all Borrowers with respect and dignity;
2. Participate in an ASIC approved External Dispute Resolution Scheme;
3. Ensure that all products carry a clear and transparent 'no negative equity' or 'non-recourse' guarantee. That is, the Borrower(s) will never owe more than the net realisable value of their property, provided the terms and conditions of the loan have been met;
4. Strongly encourage Borrower(s) to discuss the transaction with family members and to seek independent financial advice from a qualified financial adviser;
5. Strongly encourage Borrower(s) if entitled to Centrelink benefits, to discuss the transaction with Centrelink to ensure they fully understand the impact;
6. Ensure that the Borrower(s) obtains independent legal advice performed by the solicitor of their choice. Prior to the completion of the transaction, the Borrower(s) or their solicitor will be provided with full details of the benefits the Borrower(s) will receive, and the obligations they are entering into;
7. Clearly and accurately identify all costs to the Borrower(s) that are associated with the transaction;
8. Not assert or imply to a Borrower(s) that the Borrower(s) is obligated to purchase any other product or service offered by the Member or any other company in order to enter into an equity release product;
9. Provide in writing, a fair and complete package of equity release documents, covering the benefits and obligations of the product. This will include making available to the Borrower(s) and their advisers a tool illustrating the potential effect of future house values, interest rates and the capitalisation of interest on the loan; and
10. Ensure that all loans are written under the Uniform Consumer Credit Code (UCCC), irrespective of the use of proceeds from the loan. All Members will comply with the Privacy Act, Trade Practices Act any other relevant Code or Regulation at law.